
Proposed Revocation of Authorisation
of Arrangements to Jointly Market and Sell
Pohokura Gas

Submission by OMV New Zealand Limited in
Response to the Commerce Commission Draft
Determination (23 February 2005)

INTRODUCTION

1. This submission is made by OMV New Zealand Limited ("OMV"), one of the three Pohokura Joint Venture ("PJV") participants, in response to the Commerce Commission's Draft Determination on the proposed revocation of the Pohokura joint marketing authorisation ("Draft Determination"), made on 23 February 2005.
2. OMV makes this submission independently of the other PJV participants in order that it may frankly explain to the Commission the reasons that OMV ultimately chose to go to market separately with Pohokura gas in April 2004.
3. OMV is concerned that in reaching the conclusions that it has, the Commerce Commission is either unaware of important and relevant information, in particular about the activities of the PJV participants since the Commission authorised the joint marketing of gas and the factors leading to OMV's decision to go to market separately with Pohokura gas, or that the Commission did not take this information into account. Accordingly, this response to the Draft Determination proceeds by:
 - summarising OMV's submissions;
 - setting out in some detail information that OMV believes the Commission should be appraised of, and should take into account, before making its final determination; and
 - addressing the Commission's application of section 65 as set out in the Draft Determination.
4. Throughout this submission OMV uses the terminology of "going to the market separately" in order to distinguish what has occurred to date from "separate marketing and selling" of gas. In the Draft Determination the Commission refers to "selling gas separately", but separate selling has not yet commenced. Although OMV has gone to the market separately, for the reasons set out in these submissions, separate selling of Pohokura gas is yet to be assured. OMV considers that the term "separate marketing and selling" incorporates not only going to the market on an individual basis, but also the successful sale of gas on an individual basis. Whether or not Pohokura gas is ultimately sold separately is subject to []
obtaining any necessary approvals.

SUMMARY OF SUBMISSIONS

5. The position of OMV in response to the key aspects of the Draft Determination is set out below.
6. OMV does not agree with the Commission's draft finding that false or misleading information was provided to the Commission in the course of the PJV joint marketing authorisation application ("Application").
7. OMV's desire has always been to get Pohokura developed and Pohokura gas to market as soon as possible. In the context of the New Zealand market, OMV believed that the only realistic approach to achieving the key aim of commencing Pohokura production as soon as possible was to market jointly with its PJV partners. In pursuing this desired outcome, OMV was careful to avoid any behaviour that might give rise to concerns under the Commerce Act 1986 (the "Act").
8. In order to meet the targeted production date of June 2006, it was essential in OMV's view, that the PJV participants made a final investment decision ("FID") on Pohokura development no later than June 2004. In order for the PJV participants to be in a position to consider FID by June 2004 it was first necessary to agree a field development plan ("FDP"). Once the FDP was settled commercial development of gas sale agreement terms could be progressed in a substantive way. Gas sale agreements ("GSAs") with purchasers needed to be concluded by late April / early May 2004 to allow sufficient time for each of the PJV participants to complete internal processes ahead of the scheduled June FID meeting date.
9. Although OMV has gone to the market separately from the other PJV participants, the Commission is wrong to conclude that this means that separate marketing is possible and/or will necessarily achieve an early (i.e. June 2006) production start date.
10. [
11.]
11. OMV's decision to go to market separately from the other PJV participants was taken at a time when OMV assessed that the options available to develop Pohokura gas were to:

11.1 [

]

11.2 [

]

11.3 [

]

12. All of these options carried a significant degree of risk that the targeted date for first gas would not be met. A decision was only taken after careful consideration of the risks associated with each option. OMV elected to go to market separately because it believed that this offered the best option for making progress on the Pohokura development [] while preserving options for negotiating and dealing with the other PJV participants. Key aspects of OMV's risk assessment at the time it took the decision to go to market separately from the other PJV participants were:

- (a) PJV agreement on all key parameters for the FDP;
- (b) The state of negotiations on [];
- (c) An assessment by OMV that differences in approach to Pohokura field development issues were unlikely to be resolved [];
- (d) []

13. [

]

14. [

]

15. On the basis of its experience of the PJV to date, OMV strongly believes that the joint marketing authorisation in Decision 505 ("Authorisation") was vital in facilitating the progress of the PJV participants' negotiations on field development issues, because from the outset the PJV participants were approaching the negotiations from a joint marketing perspective.

16. OMV firmly believed at the time of the Application that joint marketing was necessary if Pohokura was to begin production by June 2006. OMV's experience following the Authorisation, reinforces that belief. OMV considers it is unlikely even that the FDP could have been agreed had a separate marketing approach been taken from the outset.

17. Joint marketing facilitated a co-operative approach to key work that ultimately resulted in broad agreement on the FDP.
[

]

18. For the reasons outlined in the course of the Application, OMV believed, and remains of the view that (absent the Authorisation) there would have been significant delays in reaching production from the Pohokura field by June 2006. The steps taken of going to the market separately did not (and do not) ensure the targeted early production date is met, but they preserved the possibility that this could occur.
19. For all of the above reasons OMV strongly denies that it ever provided false or misleading information to the Commission as regards the practicalities and possibility of separate gas marketing and sale or as to the anticipated difficulties and timing consequences for early production if separate marketing was required. In OMV's opinion the Commission should not assess the information provided to it in the course of the Application in the context of subsequent events. Rather it must have regard to the facts and circumstances at the time, and OMV's honestly held belief at the time as to likely future outcomes of a particular course of action. Accordingly, OMV considers that the jurisdictional prerequisite which is set out in section 65(1)(a) of the Act has not been satisfied.
20. OMV also considers that there has not been any material change in circumstances such as to justify the Commission revoking the authorisation under section 65(1)(b) of the Act and that to do so at present would be premature.
21. In the Draft Determination the Commission interchanges the concepts of the FID date and the early production of Pohokura gas in assessing whether there has been a material change in circumstances. This suggests to OMV that the Commission has concluded that, because FID has been taken on the basis of separate gas contracts by the PJV participants, separate marketing within the targeted time-frame is feasible. While OMV acknowledges that there is a nexus between FID and production, these two concepts cannot be used interchangeably. Feasibility of separate marketing and achievement of the targeted early production date is NOT established by the mere fact of going to market separately and PJV participant approval of FID, and it would be premature to reach such a conclusion [

]

22. In the Draft Determination the Commission concludes that there has been a material change in circumstances in that "the nexus between joint marketing and sale and early production no longer exists" (at paragraph 60). OMV accepts that there has been a change in circumstances, as the dynamics of the New Zealand gas market have changed since the Authorisation, due in part to the successful conclusion of the Maui Strawman negotiations. However, in OMV's opinion this in itself is not a sufficiently "material" change to support the step of revoking the Authorisation. [

] OMV requests that the Commission maintain the Authorisation. [

]

- 23.** If the Commission determines to revoke the current Authorisation, OMV requests that the Commission consider further submissions to amend the Authorisation to permit the PJV participants to undertake joint marketing activities in specific circumstances [

]

- 24.** If the Commission forms the view that it should amend the Authorisation, OMV requests that it be provided with a further opportunity to make submissions in relation to the proposed amendments.

SUBMISSIONS

OMV Honestly Believed that Going to Market Separately Would Lead to Significant Delays

25. The Draft Determination makes some clear findings and strong statements about the nature of the representations that were made to the Commission at the time of the original authorisation application. In particular the Commission finds (at paragraph 72) that the PJV participants provided it with false information about the necessity of joint marketing to meet an early production target.
26. OMV refutes the finding in the Draft Determination that the Commission was provided with false and misleading information in the course of the Application.
27. At the time the PJV participants made their submissions OMV honestly believed that it would only be possible to bring the Pohokura field to production by June 2006 if joint marketing and selling was authorised.
28. In the course of making the Application, the PJV participants presented the Commission with a range of evidence supporting the PJV participants' position that, in the context of the New Zealand gas market, the difficulties faced with a separate marketing and selling approach were substantial.
29. In the period following the grant of the Authorisation, the PJV participants actively sought to progress agreement on the FDP and the joint marketing arrangements, including the form of the GSA and the terms on which each of the PJV participants may be able to individually purchase gas from the PJV ("JV Uplift"). [

.] The FDP and commercial negotiations proceeded in parallel. While the FDP discussions were largely technical, they were critically inter-related to the GSA and JV Uplift. In particular, agreement on field deliverability, the number of wells, the size of the plant and the minimum take requirements to be imposed on gas purchasers all had important commercial dimensions.

30. Meetings between representatives of each of the PJV participants were held on a regular and frequent basis (normally weekly). When issues arose that did not appear capable of resolution in that forum, they were referred to the CEOs of the PJV participants who also met for the purpose of resolving such issues and to ensure that development discussions were progressing. There were also a number of workshops to deal with specific issues.
31. Divergence in commercial perspectives and approach on the FDP, joint marketing arrangements, GSA terms, and JV Uplift would have been even more significant in separate marketing circumstances, where each of the PJV participants would have been seeking to pursue their own particular commercial and strategic interests.

32. As early as 10 November 2003, there was general agreement between Shell and OMV (but not Todd) on the basic GSA structure, JV Uplift principles and the approach for joint marketing. In December 2003 Shell and OMV had agreed the terms of a JV Uplift Agreement. The PJV participants were still discussing and debating drafts of a joint GSA through to mid March 2004. Even as late as 25 March 2004, OMV was still considering solutions to the GSA and JV Uplift issues.
33. OMV's commitment to these processes demonstrates that OMV honestly believed that joint marketing was the only viable way of producing Pohokura gas by a June 2006 target date. It was only after agreement on key terms of the FDP, and then only when timelines to meet a June 2004 FID date became absolutely critical, with little prospect of further progress within the PJV as to agreement on a GSA and JV Uplift, that OMV seriously started to consider going to the market separately.
34. At the time of the Application OMV was not aware of any precedent for separate marketing of gas (in the true sense as opposed to arrangements called separate marketing which were, in fact, premised on joint marketing) in a market comparable to New Zealand for a development of this size. In OMV's view this supports the proposition that separate marketing in the NZ market is exceedingly difficult. In fact, the only relevant precedents of which OMV was aware were the decisions of the Australian competition authorities that separate marketing was not feasible in a market context comparable to the New Zealand market.

[]

35. [

]

36. [

]

37. [

]

38. [

]

39. [

]

40. [

]

41. [

]

41.1 [

]

41.2 [

]

41.3 [

[

42. [

]

The Joint Marketing Authorisation was Fundamental in Progressing Pohokura Field Development

43. It was only as a result of the progress made in relation to the FDP during negotiations on joint marketing [
-] that OMV was able to contemplate going to market separately. Given the difficulties experienced in circumstances where there were immediate and necessary deadlines, the likelihood of reaching a timely agreement in the absence of such pressure was in OMV's view very unlikely.
44. Despite the difficulties OMV experienced in attempting to reach agreement on key documents, OMV firmly believes that the joint marketing and selling “mindset” that the PJV participants had as a result of the Authorisation was critical in progressing the plans for the development of the Pohokura field.
45. Conversely, in a separate marketing and selling scenario, the PJV participants' interests would not have been aligned on key aspects of the development. A range of factors would come into play including the differences in each of the PJV participant's perception of the gas market, likely customer requirements, and the optimal timing for bringing gas to market. The differences between each of the PJV participants on these issues not only had the capacity to prolong negotiations significantly, they also posed the risk that any compromise ultimately reached was one which did not result in the field being utilised in an optimal way. Given the significant difficulties experienced in reaching agreement when joint marketing was the aim, OMV considers that these difficulties would only have been even more significant in a separate marketing and selling scenario.
46. One of the fundamental aspects of developing a field is the FDP. This plan gives the developers the parameters for the production of products, including gas, from the field (eg large volumes in a very short time frame, or smaller volumes produced over a longer timeframe). These parameters are in turn affected by, amongst other things, project timing, the number of wells drilled, the size and other operational parameters for the processing plant, back-up capacity and the products produced from the well stream.
47. Agreement on these key technical aspects of the field development then feeds into the marketing approach because sellers have an indication of the volume of gas that will be available in a given time, gas supply flexibility, security of gas supply, and the likely life of the field (based on a given level of probability of the estimate of the field's reserves). Sellers can then approach the market with preferred volumes and contract durations.
48. FDP discussions amongst representatives of the PJV participants and the Operator of the field, Shell Todd Oilfield Services Limited (“STOS”) had been the focus of much of the early discussions following the Authorisation, with the model for field development being constantly refined. At the end of October 2003 OMV proposed an “envelope” of key terms for sales of gas for the first five years of production (“Tranche 1 Gas”). This proposed envelope was the outcome of extensive discussion amongst the PJV participants. With one reservation, raised

by Todd, this envelope was agreed. The parameters agreed for this envelope fed directly into the final FDP.

49. It was only once the FDP was largely agreed that development of joint marketing proposals could proceed in any substantive way. Without this the PJV participants did not have sufficient comfort about what they were going to get out of the field to enable them to begin marketing. Once the FDP was largely agreed, the next step was to agree on contract terms to take the gas to market.
50. When it became increasingly apparent that the timeline for the FID to enable early production would not be met under a joint marketing scenario, one of the primary reasons OMV was able to contemplate going to market separately was the agreement on key terms of the FDP. Without this it would not have been possible to go to the market with a sales gas profile upon which a GSA for separate sales could be based.
51. The risk existed with a separate marketing strategy by OMV that notwithstanding agreement on the FDP, FID would not receive the necessary unanimous support from the PJV participants, or that an adverse FDP would be put forward under a sole risk development proposal. [

]

52. In summary the Authorisation provided a framework and impetus for concluding agreement (at least on the key terms) of the FDP and for making the FID. Put another way, had the PJV participants commenced negotiations on the FDP on the basis that there would be separate marketing and sales of gas, OMV is of the view that given the dynamics of the PJV, the PJV participants' divergent market positions and different commercial drivers and the complexity of the issues involved, those negotiations could well be going on today, and as a result the FID would not yet have been made.

Why a GBA is Necessary

53. Where more than one seller is involved in a gas field, and the gas is not jointly marketed, it is necessary for the parties to agree on a GBA. A GBA is required because gas taken from a field by a buyer or buyers will inevitably not match entitlements of the selling joint venture participants. Some of the principal reasons for this include:

- (a) most GSAs permit a buyer to vary the amount of gas taken;

- (b) default by a buyer on its obligations to take gas within a prescribed range;
- (c) deferral by a seller in marketing gas entitlements;
- (d) differing sales contract profiles between sellers; and
- (e) most importantly, buyers demand volume flexibility in their offtake arrangements with sellers so that they can cope with variation in demand.

The GBA needs to address a variety of such circumstances, and is therefore necessarily a complex arrangement to negotiate.

- 54. Addressing only paragraph (a) above as an example, the complexities associated with this one aspect of a GBA are discussed below.
- 55. Although GSAs provide for a "daily quantity", they usually also provide for a "maximum daily quantity" which is greater than the daily quantity. The seller undertakes to supply gas up to the maximum daily quantity on any given day. For example, if an electricity generator experiences increased demand for electricity generation, it will in turn need to draw additional gas to meet this increased generation demand. This increased take of gas may be greater than the "daily quantity" that was agreed in the GSA.
- 56. If this pattern is repeated over a period of time by one seller's customer or customers, this seller may end up taking more than the share of its gas based on its equity in the field. This is usually referred to as "over-lifting". Where over-lifting and/or under-lifting (where a seller takes less than its equity share of gas) occurs, it is necessary for an adjustment to be made between the sellers involved in the field. The process for this adjustment is set out in a GBA.
- 57. A GBA can provide for the adjustment to be made either by adjusting the amount of gas that each seller may take from the jointly owned field for a period into the future, delivery of gas from a different source (make-up gas), or by a payment from the overlifting seller(s) to the underlifting seller(s).
- 58. Gas based (as opposed to price based) adjustments can only occur where there is substantial diversity of gas supply or a liquid spot gas market exists that gives the participants sufficient confidence that the gas will be available in the quantity and at the rates required to cover any overlift. This is because a seller who is required to underlift may need to acquire additional gas to meet its supply obligations under its GSAs and because the seller who has overlifted may be obliged to deliver make-up gas (e.g. if there is a substantial reserves downgrade and one seller has lifted significantly more gas than other sellers). In the absence of a guaranteed ability to meet any supply shortfall imposed as a result of a GBA, a seller will not take on the commercial risks associated with this type of gas balancing.
- 59. A price based GBA imposes an obligation on an overlifting seller to pay the other sellers for the volume of gas it has overlifted. In order to make such an agreement it is necessary for each seller to agree on a price or pricing mechanism for the volume of overlifted gas.

60. However, determining price is not a straightforward exercise and encompasses more than a simple base gas price compensation for the overlifted gas. Depending on the sellers involved and the nature of the field there may be a wish to ensure that there is a significant disincentive to overlifting. Further, if overlifting by one seller causes another seller to default under its GSA it raises problems of liability because of the default. As the defaulting seller's liability under the GSA was not caused by this seller, this liability needs to be offset or met by the overlifting seller. A simple base gas price formula may not adequately compensate for the potential liability.
61. Determining a price or pricing mechanism for overlifted gas can be a highly contentious issue amongst sellers because of their different commercial circumstances, their access to other gas, their customers' demands and interests, and their different views of the state of the gas market.
62. In addition, in the New Zealand context, the agreement of sellers on a price or pricing mechanism potentially raises issues under the Act. Until liquidity of the New Zealand gas market increases significantly, the only realistic mechanism for a GBA is a price based adjustment. The setting of a gas price payable between sellers effectively sets a floor price for gas from a particular field, as it is unlikely that a seller who has overlifted would agree to pay more for the gas than they are able to charge their customer. Essentially this means that the PJV participants agree between themselves the key value parameters that determine a GSA and as a result it is arguable that an authorisation may be required.

APPLICATION OF SECTION 65

63. The cornerstone of the Commission's reasoning in the Draft Determination is that as early production now looks likely, and as this was achieved without joint marketing, the PJV participant's representations were false at the time they were made.
64. OMV disputes this conclusion. The fact that events have evolved differently than anticipated by the PJV participants at the time of the Application, is, by itself, an insufficient basis upon which to conclude that the information provided to the Commission was false or misleading. . The Commission must have regard to the facts and circumstances as they existed at the time of the Application and must assess whether, at that time, the views expressed by the PJV participants were based on an honestly held belief as to the most likely alternative outcome in the absence of the joint marketing proposal. To the extent that the Commission considers subsequent conduct by the PJV participants, this conduct again should be considered in light of all the facts and circumstances surrounding the conduct.
65. As set out above, OMV had an honestly held belief at the time of the Application that joint marketing and selling was the only practical way of meeting an early production target for Pohokura. Following the Authorisation, the PJV participants invested a significant amount of time and effort in negotiating the arrangements associated with the development of the field and joint marketing of gas. In particular, a FDP was agreed between the parties. OMV takes the view that the joint marketing approach imposed a shared position on the PJV participants which was crucial to progressing the FDP and the general framework to the sale of Tranche 1 Gas.
66. Throughout this process OMV's overriding objective was to develop Pohokura and get gas to market at the earliest possible date. It was only when faced with the certain prospect of not being in a position to make a FID by June 2004 that OMV considered whether alternative options were possible.
67. [

]

68. [

]

69. [

]

70. [

]

71. For the reasons set out above, OMV does not agree with the Commission's draft finding that the Commission was provided with information that was false or misleading in a material particular.

72. Accordingly, OMV does not agree that the requirements of section 65(1)(a) are satisfied.

73. At paragraph 48 the Commission notes that 'Presumably, in that short length of time, the 'difficult or impossible practical problems' have been overcome and it has become 'feasible' to separately market and sell Pohokura gas.' For the reasons noted above this statement is not correct. [

]

74. At paragraph 78 the Commission makes the assumption that "... joint marketing and sale after the final investment decision would not have accelerated progress towards the early operation of the field." This assumption is the basis on which the Commission determines that there has been a change in market conditions or other relevant circumstances, and that this change is a material one.

75. OMV submits that this assumption is incorrect. [

]

76. [

]

77. OMV acknowledges that there has been a change in circumstances, which it would characterise as "a final investment decision was made in June 2004 on the basis of going to market separately." The Commission has characterised the change as "the nexus between joint marketing and sale and early production no longer exists" at paragraph 60, and has concluded that this change is material, thereby satisfying the requirement of section 65(1)(b).

78. OMV's view is that it is premature to speculate that this nexus has been severed. and requests that the Commission maintain the Authorisation.

79. [

]

80. If the Commission determines to revoke the current Authorisation, OMV requests that the Commission consider further submissions to amend the Authorisation to permit the PJV participants to undertake joint marketing activities in specific circumstances[

]

81. If the Commission forms the view that it should amend the Authorisation, OMV requests that it be provided with a further opportunity to make submissions in relation to the proposed amendments.

CONCLUSION

82. OMV has set out in some detail the activities of the PJV participants in the period following the Commission's granting of the Authorisation in order to explain to the Commission OMV's reasons for moving from joint marketing to going to market separately. OMV's key reason for moving to going to market separately was because of extreme difficulties in reaching agreement within the PJV on key items that affected the likelihood of meeting the targeted production date of June 2006.

83. For these reasons OMV denies that it provided the Commission with false or misleading information.

84. [

] Accordingly, OMV requests that the Commission maintain the current Authorisation.

- 85.** If the Commission is not minded to maintain the current Authorisation, OMV requests that the Commission consider further submissions to amend the Authorisation to encompass any joint marketing activities that may be required to achieve the targeted production date.
- 86.** If the Commission does decide to amend the Authorisation, OMV would seek an opportunity to provide further submissions to it.

Steve Hounsell
Managing Director
OMV New Zealand Limited